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The Federal Bankruptcy Act and its Effect on State Insolvency Laws

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THE FEDERAL BANKRUPTCY ACT AND ITS EFFECT ON STATE INSOLVENCY LAWS.—Since *Sturgis* v. *Crowninshield,* 4 Wheat. 122, it has been clear that State Insolvency Laws were valid (within certain well-defined limits) during the non-existence of a Federal Bankruptcy Act, and that upon the enactment of a Federal Bankruptcy Act the State laws were superseded and suspended so far as they were in conflict with the Federal legislation. The difficulty has been in determining when there was such conflict, and it has arisen in various ways. For instance, the Federal Bankruptcy Act permits any natural person to become a voluntary bankrupt, but provides that no involuntary proceedings shall be taken against a farmer or a wage earner, or a person owing less than $1,000. The question has frequently been raised whether State Insolvency Laws are still effective in the cases of persons thus exempted by the Federal Act, and has been variously decided. See *Littlefield* v. *Gay,* 96 Me. 422; *Lace* v. *Smith,* 34 R. I. 1 (commented on in 11 MICH. L. REV. 60); *Rockville Bank* v. *Latham,* 88 Conn. 70; and *Pitcher* v. *Standish,* 90 Conn. 601 (commented on in 15 MICH. L. REV. 68). The Supreme Court of the United States, in the recent case of *Stellwagen* v. *Clum,* 38 Sup. Ct. 215, has now passed on another phase of the same question.

An Ohio statute (§§ 6343-4, Rev. Stat. Ohio; §§ 11102-5, General Code of Ohio) provides that if an insolvent debtor makes a conveyance or suffers a judgment with intent to hinder, delay or defraud creditors, or with intent to prefer one or more creditors, such conveyance or judgment shall be void at the suit of any creditor; and in such creditor's suit "a receiver may be appointed who shall take charge of all the assets of such debtor * * * including the property so sold, transferred, mortgaged, or assigned, which receiver shall administer all the assets of the debtor * * * for the equal benefit of all the creditors of the debtor * * * in proportion to the amount of their respective demands * * *." An insolvent corporation in Ohio made conveyances of lumber, which fell within the terms of the above statute; more than four months later it made a general assignment for the benefit of its creditors and a few days later was adjudicated bankrupt. Its trustee in bankruptcy was in possession of the lumber thus conveyed, and the vendee in the conveyances filed a petition asking that the lumber be turned over to him. The trustee in bankruptcy insisted that the conveyances made to the petitioner were fraudulent and voidable. But as the conveyances were made and completed more than four months before bankruptcy he could not rely upon § 60b, which gives the trustee power to avoid and recover preferences, nor upon § 67e, which gives him power to avoid fraudulent transfers; both of these sections require that the transaction avoided must have taken place within four months before bankruptcy. § 70e, however, provides that "the trustee may avoid any transfer by the bankrupt which any creditor of such bankrupt might have avoided" and places no four months' limitation of time upon the trustee. The trustee of the bankrupt corporation therefore relied on § 70e in seeking to avoid the conveyances to the petitioner, and based his right upon the right which "any creditor" would have under the Ohio statute. He was met with the contention that the Ohio statute, because it provides for the appointment of a receiver to administer the debtor's assets for the benefit of all his creditors, is suspended by the existence of the Federal Bankruptcy Act. The District Court dismissed the petition, holding that the Ohio statute was not suspended and that the trustee in bankruptcy was therefore empowered to avoid the conveyances. The Circuit Court of Appeals for the Sixth Circuit (in 218 Fed. 730, 134 C. C. A. 408) was unable to reach a satisfactory conclusion, and certified the question to the Supreme Court, which held that the Ohio statute was not suspended by the Federal Bankruptcy Act.

The Supreme Court cited, in support of its decision that the Ohio statute was not a bankruptcy law, *Mayer* v. *Hellman*, 91 U. S. 496 and *In re Farrell*, 176 Fed. 505, 100 C. C. A. 63. Both of these cases passed on an Ohio statute governing assignments for the benefit of creditors and containing provisions, both for a receiver and for distribution of the debtor's assets, substantially like those in the statute considered in the principal case; and both cases held that the assignments made under the statute were good. The principal case of course goes much further; it holds not merely that a statutory assignment passes title—which might have passed without the aid of the statute—but that the making of a fraudulent or preferential transfer shall have the possible effect of turning all of the debtor's property into the hands of a receiver who shall use it for the benefit of all the creditors.

The legality, pending the existence of a Federal Bankruptcy Act, of similar provisions in State Insolvency laws has been questioned in numerous cases, and it seems clear that in most cases the decisions have been against their validity. In *Ketcham* v. *McNamara,* 72 Conn. 709; *Capital Lumber Co.* v. *Saunders,* 26 Idaho 408; *Closser* v. *Strawn,* 227 Fed. 139; and *Hasbrouck* v. *La Febre,* 23 Wyo. 367, State statutes provided for insolvency proceedings and gave power to an assignee or receiver to set aside preferential and fraudulent transfers made by the insolvent; in all of these cases suits were brought to set aside such transfers, and in each case it was held that the suit must fail because the State statute, being in conflict with the Bankruptcy Act, was suspended. And in *Pelton* v. *Sheridan,* 74 Ore. 176, it was held, under a similar statute, that the insolvent's subsequently appointed trustee in bankruptcy could not invoke the provision of the State statute to set aside an attachment. It is difficult to reconcile these decisions, especially *Pelon* v. *Sheridan,* with the principal case, except on one ground, namely, that in all of these cases the State statutes provided for a discharge of the insolvent's debts, while in the Ohio statute there is no such provision. This point is referred to in the opinion of Mr. Justice DAY, who says: "And while it is not necessary to decide that there may not be state insolvent laws which are suspended although not providing for a discharge of indebtedness, all the cases lay stress upon the fact that one of the principal requisites of a true bankruptcy law is for the benefit of the debtor in that it discharges his future acquired property from the obligation of existing debts."

An interesting instance of the same distinction is furnished by the two Maine cases of *Moody* v. *Development Co.,* 102 Me. 365, and *Carter, Carter & Meigs Co.* v. *Stewart Drug Co.,* 115 Me. 289. A Maine statute, passed in 1905, provided for the winding up of insolvent corporations by the appointment of a receiver, and also provided, *inter alia,* that all claims not duly presented should be barred. Proceedings under this statute were dismissed in the *Moody* case on the ground that the statute was an insolvent law and was therefore overridden by the Federal Bankruptcy Act. Subsequently the State statute was amended by repealing the provision for the barring of claims, and when the validity of the amended law was presented in the *Carter* case the Supreme Judicial Court of Maine upheld it, saying: "It was evidently the judgment of the Legislature that the amendment met and overcame the objections set forth in *Moody* v. *Development Co.* * * * [and] freed the Act of 1905 from its unconstitutional features, and such appears to have been the opinion of this court."

There is, therefore, authority for making the broad distinction which has been suggested, namely, that a State statute is suspended and superseded if it attempts to bar or discharge debts, and it is continued in force if it does not. But it is clear that this distinction, broad and simple though it be, has not been unanimously approved. See *In re Weedman Stave Co.,* 199 Fed. 948, holding that a State statute will be suspended even though it does not provide for a discharge, and see also the cautious language of Mr. Justice DAY, quoted above from the opinion in the principal case.

And on the other hand, it is argued with some plausibility that such a State statute, even though it provides for a discharge of the debtor, may yet be given effect as to its other provisions. The provisions for discharge are of course suspended by the Federal Bankruptcy Act, but this does not necessarily suspend the statute *in toto*, (*Boese* v. *King*, 108 U. S. 379) and other provisions of the statute may well be enforced, especially under circumstances like those in the principal case and in *Pelton* v. *Sheridan*, *supra*, where because of the four months' limitation, the trustee would be remediless under the Bankruptcy Act, and where the enforcement of the apposite provisions of the State statute would result in a benefit to many creditors instead of one transferee. As is pointed out in the principal case, the suspension of the Ohio statute would result in turning over to the fraudulent vendee "a part of the estate which is being administered in bankruptcy, although the conveyance under which the property is claimed is voidable under the laws of the State where it was made and the alleged right in the property secured. We think that Congress in the Bankruptcy Act did not intend any such result, but meant to permit the trustee in bankruptcy to have the benefit of state laws of this character which do not conflict with the aims and purposes of the Federal law." So, too, in *Pelton* v. *Sheridan*, *supra*, in a dissenting opinion by Mr. Justice BENNETT, it is said: "The tendency of the federal decisions on this point, of which *Randolph* v. *Scruggs*, 190 U. S. 533, 537, is an example, seems to be to treat the assignment as valid and to recognize it so far as it is an aid of the purpose of the law and beneficial to the bankrupt's estate. In its effect of dissolving the previous attachment in the state court, the assignment was advantageous to the bankrupt's estate and efficient in carrying out the general design of the law to provide an equal distribution of his estate for the benefit of all his creditors in proportion to the amounts of their respective claims. * * * Upholding the attachment, under the circumstances of this case, is at variance with this policy and secures to one creditor a preference by reason of his attachment, which was dissolved by the assignment under the state law, while the opposite determination of the issue will give effect to the intent of both state and federal legislation." The cogency of this argument is obvious, and it applies to provisions in state statutes which contain other provisions barring claims of creditors (as in the Connecticut, Idaho, Oregon, Pennsylvania and Wyoming statutes considered in the cases cited *supra*) just as effectively as to provisions in state statutes which do not contain such other provisions (as the Ohio statute in the principal case). As is indicated above, the cases in the state courts are clearly against this view, but the Supreme Court of the United States is not yet committed on the question, and there is basis in its opinions for an argument in favor of the more liberal view—a view which, it is submitted, would serve better to accomplish the desirable result of administering all of a bankrupt's estate for the benefit of all his creditors. E. H.